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No. 07-1010

FILED

MAR 27 2008

OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

LEHMAN BROTHERS BANK, FSB,
Petitioner,

v.

STATE BANK COMMISSIONER,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Delaware

BRIEF IN OPPOSITION TO LEHMAN BROTHERS BANK, FSB'S PETITION FOR A WRIT OF CERTIORARI

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March 27, 2008

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QUESTIONS PRESENTED FOR REVIEW

Should this Court review the decision of the Delaware Supreme Court that rejected Commerce Clause and Due Process Clause challenges to the Delaware Bank Franchise Tax branch/subsidiary apportionment system as applied to a Delaware domiciliary bank, where the apportionment system as applied met the requirements of the Federal Home Owners' Loan Act, 12 U.S.C. § 1461 *et seq.*, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and later cases, particularly when subsequent amendments to the Delaware Bank Franchise Tax statute leave the decision below with no practical effect going forward?

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STATEMENT OF THE CASE

Lehman Brothers Bank, FSB ("Lehman Bank" or the "Bank") is a federal savings bank chartered under the Federal Home Owners' Loan Act ("HOLA"), 12 U.S.C. § 1461 *et seq.*, with its home office located in Wilmington, Delaware. (App. 4a). Approximately 97% of the Bank's income comes from lending in the residential mortgage market, which generates income from the net interest margins between its costs of funds and borrower payments. (App. 5a, 113a n. 29). The Bank holds mortgages briefly, transferring them on average within 45-60 days to its holding company,

Lehman Brothers Holdings, Inc. ("Lehman Holdings"), which in turn securitizes the loans. (App. 5a, Pet. for Cert. at 7). The Bank earns about 4% net interest on loans while it holds them, which comprises the bulk of the total income for the Bank. (App. 5a, 113a n. 29).

Prior to 1999, Lehman Holdings funded its mortgage business through unsecured bank loans, borrowing on the commercial paper market and entering into long-term repurchase agreements. (App. 3a-4a). The borrowing costs were high and the business model was unstable, as funds become scarce with any disturbance in the global financial markets. (App. 4a, 98a). Consequently, Lehman Holdings sought to acquire a federal savings bank in which to conduct its nationwide mortgage lending operation and had been in contact with the Office of Thrift Supervision ("OTS") for a number of years in regard to its search. (App. 4a, 98a, 144a).

When the opportunity arose to acquire Delaware Savings Bank, FSB, Lehman Holdings approached OTS with a bid. Lehman Holdings purchased Delaware Savings Bank, FSB for $2 million and changed its name to Lehman Brothers Bank, FSB. (App. 4a, 144a). On June 30, 1999, OTS issued an amended Federal Stock Charter to the Bank, with a home office designated as Wilmington, Delaware, which remains its home office today. (App. 4a, 16a).

Lehman Holdings promptly moved its mortgage related business into Lehman Bank as the funds necessary to fuel the residential mortgage business were now able to be originated by, and run through, the Delaware office of the Bank. (App. 3a-5a, 98a-99a, 36a-37a). Indeed, while the source of funds for the business was limited to the volatile commercial

market prior to the acquisition, Lehman Bank was now able to secure funds from two new sources, making up at least 90% of the total source of funds for the mortgage business. (App. 36a n.73). First, since the Bank designated its home office in Delaware, the Bank gained access to the Federal Home Loan Bank ("FHLB") of Pittsburgh. (App. 4a). With this access came a ready and stable source of funds at 70 cents on the dollar at reasonable rates. (App. 98a). Second, the Bank issued certificates of deposits ("CDs") from its Delaware office. (App. 36a). The CDs were very important to the Bank and constituted a major part of its business, as they also reduced the cost of funds available for mortgage lending. (App. 4a-5a). Because only a bank may accept deposits and because Lehman Bank's sole banking office was in Delaware during the years at issue, all deposits were accepted in Delaware and CDs were issued out of the Delaware office of the Bank. (App. 36a-37a). It could do so nowhere else. *Id.* A Bank representative testified:

> [W]e sent the money to Delaware because that's where . . . our operating account was. . . . [I]t has to hit the books and records somewhere. It can't really hit your books and records in New York. It has to hit your books and records in the bank.

(App. 36a n.74). In short, with the acquisition of Delaware Savings Bank, FSB, Lehman Holdings' entire mortgage business moved to the Delaware-based Bank, with over 90% of the funds necessary to fuel that business a direct result of the Bank having its principal place of business in Delaware. (App. 36a-37a & n.73).

The stable, low-cost source of funds was more profitable than originally anticipated. (App. 149a). The Bank's net operating income before taxes, as reported to OTS as part of the required Thrift Financial Reports, revealed that the Bank's income jumped from $24,150,000 for the Quarter Ending March 31, 2000 to $161,076,000 for the Quarter ending December 31, 2003. (App. 149a-150a). Thus, the Bank enjoyed a 667% increase in its income over the four-year period in question.

In its Delaware Bank Franchise Tax ("Bank Tax") filings, Lehman Bank successively took three different positions to report less than all of its income taxable in Delaware, claiming that it was entitled (1) to a deduction for a foreign branch or operation, (2) to an unexplained reduction, or (3) to be treated as the Delaware branch of a foreign bank (App. 7a-9a). In support of the last position, and because there was no separate profit and loss statement for the Delaware office, the Bank's accountants prepared amended tax returns based on a reconstructed separate profit and loss statement, and a report in factual support of the amended returns. (App. 9a). The amended returns claimed refunds of approximately $14 million. (App. 9a). The separate accounting methodology used in preparing the amended returns was subsequently reviewed by PricewaterhouseCoopers (App. 207a-220a).

In response to Lehman Bank's tax filings, the Delaware State Bank Commissioner ("Commissioner") issued assessments and denied related refund requests. Lehman Bank disputed the assessments, and the Commissioner held a hearing to resolve the issues for the assessments and refund requests for tax years 2000 through 2003. (App. 8a-10a, 102a-104a).

Before 2006, the only apportionment method under the Bank Tax statute was on a branch/subsidiary basis.[1] Del. Code Ann. tit. 5, § 1101(a), (b). Thus, under Section 1101(a) of the Bank Tax statute, all of the net income of a federal savings bank headquartered in Delaware is taxed, unless the bank has an authorized branch in another state or has a subsidiary, in which case the income attributable to the branch or subsidiary is excluded to the extent it was taxed by another state. Conversely, under Section 1101(b), a federal savings bank with its headquarters outside the State was taxed only on the income attributable to a branch in Delaware.

Lehman Bank's home (indeed only) office and headquarters were in Delaware and it had no branches or subsidiaries anywhere. (App. 17a-19a). HOLA provides that a state may impose a tax on a federal savings association no greater than the tax imposed on similar local institutions. 12 U.S.C. § 1464(h). Therefore the Commissioner treated Lehman Bank as a domestic institution as required by HOLA, included all of its income in the Bank Tax base as required by the Bank Tax statute, sustained the assessments and denied the refunds. (App. 10a 103a). The Commissioner concluded that the imposition of tax met the requirement of HOLA and did not contravene applicable U.S. Constitutional law. (App. 103a-104a). The Delaware Superior Court affirmed on November 30, 2006. (App. 96a-134a). The Delaware Supreme Court affirmed on November 7, 2007 (modified Nov. 9, 2007). (App. 1a-95a.)

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[1] Regular business corporations are subject to the Delaware Corporation Income Tax, Del. Code Ann. tit. 30, § 1901 *et seq.*, which uses a three-factor apportionment formula based on property, payroll and sales.

Lehman Bank claims in its Petition for Writ of Certiorari that it paid substantial income taxes to other states, based on a one-page summary sheet contained in a PricewaterhouseCoopers' separate accounting review. (Pet. for Cert. at 8-12). However, the Delaware Superior Court held, and the Delaware Supreme Court affirmed, that Lehman Bank failed adequately to prove what was allegedly being taxed in other states, since the one-page document did not lay out the kind of tax being imposed nor state whether it was imposed on the same mortgage interest income or included other transactions. (App. 21a-22a, 138a).

In 2006, Delaware amended its Bank Tax statute, giving banks the option to elect a second form of apportionment, based on factors for real and tangible personal property, payroll and receipts, together with a minimum tax. Del. Code Ann. tit. 5, § 1101A. Thus, for tax years after 2006, a bank has two options to apportion its taxable income, including a method of apportionment comparable to that urged by the Bank. (App. 31a-32a).

REASONS FOR DENYING THE PETITION

The Petition for Certiorari should be denied because: (1) the decision by the Delaware Supreme Court correctly applied the applicable decisions of this Court interpreting the Commerce Clause, U.S. Const. art. 1, § 8, cl. 3, and Due Process Clause, U.S. Const. amend. XIV, § 1; (2) the decision does not conflict with decisions of this Court or other courts; and (3) the Bank Tax statute at issue has been amended, with the result that the issues raised by the Bank have no future import.

A. The Delaware Supreme Court Followed This Court's Precedents

The Delaware Supreme Court correctly followed the applicable law and precedents of this Court in concluding that the inclusion of Lehman Bank's entire net income in the Bank Tax base did not violate the U.S. Constitution.

As stated, HOLA provides that a state may impose a tax on a federal savings association no greater than the tax imposed on similar local institutions. 12 U.S.C. § 1464(h). In substance, the federal statute requires that a federal savings association be treated as a domestic institution. Since Lehman Bank had its home office and was headquartered in Delaware, the Delaware Supreme Court treated Lehman Bank as though it were a domestic institution, as required by HOLA.

Even if the dormant Commerce Clause requirements stated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), apply to the taxation of the net income of a domestic taxpayer,[2] the Delaware Supreme Court correctly held that the apportionment regime of the Bank Tax met the standards of *Complete Auto*, *supra*, and other U.S. Constitutional requirements. Since HOLA requires that the taxation of a federal savings association must track the taxation of a domestic depository, the applicable

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[2] The Delaware Supreme Court held that the *Complete Auto* test controls the Commerce Clause analysis. If this Court were to hear this case on the merits, the Commissioner would argue that the decision below should be sustained on the additional ground that the dormant Commerce Clause does not apply to a state net income tax imposed on a domestic taxpayer (as opposed to a foreign taxpayer).

standard is whether Delaware's branch/subsidiary apportionment system as applied to a domestic institution met the applicable U.S. Constitutional requirements.[3] The Delaware Supreme Court correctly concluded that it did, for the following reasons.

The Delaware Supreme Court followed the rules for the application of the dormant Commerce Clause to the taxation of business corporations that are summarized in *Complete Auto, supra*. This Court held in *Complete Auto* that a state tax will not offend the dormant Commerce Clause if: (i) the activity taxed has a substantial nexus to the state, (ii) the tax is fairly apportioned, (iii) the tax does not discriminate against interstate commerce, and (iv) the tax is fairly related to the services provided by the state. *Id.* at 279-87. Lehman Bank claims that the second requirement—fair apportionment—was not met here; it does not argue that the Bank Tax fails to comply with the three other requirements. (App. 26a n. 50).

Delaware's branch/subsidiary system of apportionment provided fair and reasonable apportionment for a bank, since a bank is a unique form of taxpayer, and banks have historically been treated as a special class of institution, due to their critical role in local, state and national economies. (App. 137a). Bank operations are controlled by strict federal and state regulation. (App. 34a, 137a-139a). Only an institution chartered by a state or the federal government can engage in banking, and only if it meets stringent

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[3] If this Court were to hear this case on the merits, the Commissioner would argue that the decision below should be sustained on the additional ground that Congress' adoption of 12 U.S.C. § 1464(h) precludes the application of any dormant Commerce Clause analysis. The Delaware Supreme Court did not accept this argument.

financial and operational requirements, including regular examination by regulatory authorities. (App. 20a, 34a, 137a-139a). Among other requirements, the critical activities of a bank, such as taking deposits and making loans, may be conducted only at authorized locations. (App. 20a, 138a-139a). Further, federal law provides that all of a federal savings bank's activities are subject to the direction of its home office. 12 C.F.R. § 545.91. Historically, banks have been taxed based upon their state of residence. *Sect. Taxation, Am. Bar Assoc., State & Local Taxation of Banks and Other Financial Institutions* (1955). Therefore, it is reasonable to base a system of apportionment on the location at which the critical activities are authorized. The branch/subsidiary apportionment provisions of the Bank Tax properly address the distinct regulation and operation of banks, and permit Delaware to administer the Bank Tax in an efficient, accurate and fair manner, without imposing additional or unfamiliar requirements on bank taxpayers.

States enjoy wide latitude in devising a constitutionally sufficient method of permitting taxpayers to divide income earned within and without the state. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (approving single factor apportionment formula based solely on locus of sales); *Atlantic Richfield Co. v. Alaska*, 705 P.2d 418 (Alaska 1985) (separate accounting method held constitutional). Indeed, this Court has refused to prescribe a single constitutionally required method of apportioning income. *Moorman*, 437 U.S. at 278; *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 195 (1995).

To be fairly apportioned, an apportionment system must be both internally and externally consistent.

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 169 (1983). The internal consistency test is met where imposition by every other state of a tax identical to the one at issue does not result in multiple tax on interstate commerce. *Jefferson Lines*, 514 U.S. at 185. Actual double taxation that is occasioned by two states having different apportionment systems is irrelevant; there is no constitutional rule against double taxation. *Moorman*, 437 U.S. at 272, 277-78. Here, if all states had adopted a bank tax with branch/subsidiary apportionment, each state would have taxed only that income earned within the state, and no more than 100% of an institution's tax base would have been taxed. Therefore, the internal consistency test was met here.

External consistency requires that the factors used in apportioning income reflect a reasonable sense of how income is generated. *Container*, 463 U.S. at 169. Delaware's branch/subsidiary system did not have to be the only method of apportioning income, nor did it have to be the "best" method in the view of any particular taxpayer. *Id.* It simply has to be reasonable. *Id.* The Bank Tax met this test. The Delaware apportionment system was based on the already existing home office, branch and subsidiary regulatory scheme. (App. 31a, 34a). The business that a bank can conduct in each jurisdiction is restricted, the places that it can conduct that business are specified, and a detailed system of regulatory accounting and financial control is imposed. (App. 34a). The comprehensive regulatory accounting system naturally lends itself as an apportionment framework. In short, a system of accounting that ensures the financial soundness of a bank provides a logical basis to apportion its income.

The branch/subsidiary apportionment system fairly apportioned the Bank's income and reasonably reflected how such income was earned. The Bank's home office during the years at issue was Delaware, which is the place from which all of its activities were directed. (App. 4a, 16a). 12 C.F.R. § 545.91. As a result, Lehman Bank was a member of the FHLB system by virtue of being a federal savings association and it was able to receive advances from the FHLB of Pittsburgh by virtue of being a Delaware-based bank, thus providing a low-cost stable source of funds for the Bank's business. (App. 4a, 37a, 98a). 12 U.S.C. §§ 1429, 1430; 12 C.F.R. § 950.2. Lehman Bank was able to borrow from the public through FDIC-insured deposits. (App. 36a-37a). The Bank accepted all insured deposits in Delaware, as it is the only place it could legally do so. (App. 36a-37a). The Bank admitted that deposits had to "hit your books and records in the bank", that is, in Delaware. (App. 36a n.74). The cost of funds dropped precipitously from the time when the mortgage business was operated by Lehman Holdings, because Lehman Bank obtained access to stable, low-cost funding only available to it as a Delaware-based bank. In fact, the new funding supported virtually all of the Bank's lending activities, generating almost all of its income. (App. 36a, 36a n.74). This benefit, derived exclusively from Delaware, is what the tax reaches, and the income earned from this funding is reasonably included in the measure of that benefit. It is reasonable to attribute income generated by deposits to the place the Bank is given its franchise to operate, the sole location at which deposits can be accepted, and the location of the home office that determines from what FHLB regional office it can borrow. (App. 36a-37a). Accordingly, the Bank's funding and

income generated therefrom is reasonably attributable to Delaware.

Lehman Bank and amici curiae, Council on State Taxation ("COST")[4] and U.S. Bancorp, argue that Delaware taxes on an unapportioned basis income which other states are taxing on an apportioned basis, and that the alleged double taxation render the Bank Tax unconstitutional. They are incorrect on both counts. Delaware does not impose an unapportioned tax. The Bank Tax is apportioned based on branches and subsidiaries. If the Bank chooses to conduct its income-generating activities in such a way that the Bank fails to qualify for the Bank Tax apportionment factors, the result does not violate the Commerce Clause. So long as an apportionment system is both internally and externally consistent—which the Bank Tax is, as discussed above—either the risk of, or even actual, multiple taxation occasioned by differences in state apportionment systems does not invalidate any particular state's tax. *Moorman*, 437 U.S. at 272, 277-78; *Container*, 463 U.S. at 192-93. As stated by this Court in *Moorman, supra*, "[s]ome risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income." *Moorman*, 437 U.S. at 278. This Court has refused to require a state "to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation." *Container*, 463 U.S. at 193. Moreover, this Court has refused to find that the Commerce Clause requires national uniform rules for the division of income, *Moorman*,

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[4] While Lehman Bank is not a member of COST, an affiliated entity, Lehman Brothers, Inc., is a member.

437 U.S. at 279-80, and has refused to base the validity of any one state's tax on "the shifting complexities of the tax codes of 49 other States." *Armco Inc. v. Hardesty*, 467 U.S. 638, 645 (1984).

Even if Lehman Bank and amicus curiae were correct on this legal point, the issue is not properly positioned for disposition by this Court, as Lehman Bank failed to prove below that it was subject to double taxation. The courts below held that Lehman Bank's proof was inadequate and failed to meet its burden of showing double taxation. (App. 21a-22a, 38a).

Lehman Bank also argues that a separate accounting analysis by its accountants shows that the Bank Tax reached too much of Lehman Bank's income. The Delaware Supreme Court correctly rejected the argument. Separate accounting is neither constitutionally required nor an acceptable standard for measuring income against which other methods can be compared. *Container*, 463 U.S. at 190; *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 223 (1980). *See Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 317 (1994). In any event, the Delaware courts found that Lehman Bank failed to present a credible separate accounting analysis. (App. 21a-22a, 38a, 131a-132a).

For reasons similar to those discussed above, there was no violation of the Due Process Clause. Lehman Bank cites cases for the proposition that income must be rationally related to the taxpayer's in-state activities, such as *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), *Exxon*, *supra*, *Moorman*, *supra*, and *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931). However, as discussed above, the income taxed by Delaware was rationally related

to Delaware, when the two most important factors in producing that income were access to the FHLB of Pittsburgh and the ability to issue insured CDs, both of which were directly attributable to the home office in Delaware.

Lehman Bank and amici argue that only 2% of the Bank's income was earned in Delaware, as though the 2% ratio were a fact. It is not a fact. Rather, the 2% ratio is an argument that the Bank made but failed to prove below. The Commissioner properly rejected the argument that the separate accounting method utilized by Lehman Bank accurately measured the income of the Bank with its home and only office in Delaware, for the reason (among others) that it ignores the unique nature of a bank and the critical powers to accept deposits and borrow from the FHLB, both of which depended entirely on the Bank's Delaware home office. (App. 153a-154a).

B. The Delaware Supreme Court Decision Does Not Conflict With Precedent Of This Court

The decision of the Delaware Supreme Court does not conflict with prior decisions of this Court. There is no material difference between the Delaware Supreme Court decision and the cases cited by Petitioner and its amici regarding the principles applicable when considering a challenge to the apportionment scheme of a statute. There are differences in the identity and form of the taxpayer, the nature of the tax, and the facts and circumstances among the cases. Consequently, the discussion and the result in any particular case may be different, but that is because the facts are different, not because the legal principles applied are different.

The Delaware Supreme Court decision does not conflict with this Court's modern cases on the application of the Commerce Clause to interstate commerce: *Hunt-Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S. 458 (2000), *Goldberg v. Sweet*, 488 U.S. 252 (1989), *Container, supra*, *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), and *Complete Auto, supra*. The cases hold that a state must fairly apportion the income of a foreign business corporation engaged in interstate commerce, but they do not dictate how a state must apportion. None of the cases cited involved a bank, an entity required by federal law to be treated as a domestic institution, or even a domestic corporation. Delaware does not take the position that it need not apportion its Bank Tax; it does apportion the Bank Tax, even for domestic banks, on a branch/subsidiary basis. The Delaware Supreme Court correctly concluded that the branch/subsidiary apportionment scheme was fair and reasonable, for the reasons discussed above.

With no cases involving a bank, Lehman Bank and the amici cite older gross receipts and property tax cases. For example, *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948), involved a gross receipts tax imposed on gross income from utility services, specifically, bus service. It held that New York could not impose an unapportioned tax on receipts from bus services that were performed out-of-state. Similarly, *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), involved a tax on gross receipts for the privilege in engaging in business activity, *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307 (1938), involved a tax on gross income from business and invested capital, and *Meyer v. Wells Fargo & Co.*, 223 U.S. 298 (1912), involved a tax on gross receipts of public-service corporations. Lehman Bank is not

subject to a gross receipts tax. Further, as discussed above, the Bank Tax is not unapportioned, unlike many of the gross receipts taxes in the cases cited. Finally, even if these cases were applicable, the fact that some portion of a company's activities take place outside the taxing state does not mean that such state is prohibited from taxing 100% of the gross receipts from such activities. See *Ford Motor Co. v. City of Seattle*, 156 P.3d 185, 190-192 (Wash. 2007), *cert. denied*, --- U.S. ---, No. 07-623, 2008 WL 423568 (Feb. 19, 2008).

Norfolk & Western Railway Co. v. Missouri State Tax Commission, 390 U.S. 317 (1968), was a property tax case, holding that Missouri could not impose a tax on rolling stock on a miles-apportionment formula basis that was widely at variance with an actual count of the items and values of rolling stock present in the state. Property taxes were also an issue in *Northwest Airlines v. Minnesota*, 322 U.S. 292 (1944), *Central Railroad Co. v. Pennsylvania*, 370 U.S. 607 (1962), *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952), *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169 (1949), *Wallace v. Hines*, 253 U.S. 66 (1920), *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194 (1905), *Fargo v. Hart*, 193 U.S. 490 (1904), *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897) and *Pullman's Palace Car Co. v. Commonwealth of Pennsylvania*, 141 U.S. 18 (1891). *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), involved the taxation of property owned by a foreign nation, implicating additional requirements and considerations under the Foreign Commerce Clause that are not applicable here. *Japan Line*, 441 U.S. at 446-51.

Lehman Bank and the amici argue that the gross receipts and property tax cases require apportionment of a net income tax, but this Court has never so held. In any event, income taxes are different than gross receipt taxes and property taxes. The apportionment of net income is, as this Court has observed, akin to "slicing a shadow." *Container*, 463 U.S. at 192. A gross receipt, by contrast, is an actual event and personal property can be geographically located, even if it moves around. Net income, however, must be attributed to a jurisdiction by other factors, which is why this Court gives wide leeway to what factors a state chooses. *Moorman*, 437 U.S. at 278; *Jefferson Lines*, 514 U.S. at 195. Here, the Bank Tax was apportioned, based on branches and subsidiaries. Given the unique nature of a bank and its particular powers, the attribution of net income with respect to those factors is eminently reasonable for the reasons discussed above.

Jefferson Lines, supra, actually permitted an unapportioned tax, but it has no application here because it was a sales or consumption-type tax case. Likewise, *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938), permitted an unapportioned tax, but using an analysis that pre-dated *Complete Auto, supra*.

Lehman Bank also argues that the decision below contravenes *Kraft General Foods, Inc. v. Iowa Department of Revenue*, 505 U.S. 71 (1992). This argument too is incorrect. In *Kraft, supra*, this Court found an Iowa corporate income tax statute to be facially discriminatory, in contravention of the Commerce Clause tests in *Complete Auto, supra*, because it denied a dividends-received deduction for dividends from foreign subsidiaries, but granted the deduction

for dividends from domestic subsidiaries. This Court rejected Iowa's argument that its discriminatory taxing scheme was saved by showing that the taxpayer could have avoided the result by changing the form in which it conducts its business—that is, by having its subsidiaries incorporated in the United States instead of overseas. Lehman Bank has not argued, and no court has held, that the Bank Tax is discriminatory in nature. (App. 26a n. 50). Second, Lehman Bank incorrectly argues that the Bank Tax's branch/subsidiary apportionment system is based on the *form* in which an institution conducts its business, instead of how the income was earned. As discussed above, a bank is a governmentally franchised, geographically restricted and regulated business that can conduct the activities that give rise to its income only at a location authorized by the regulator. Thus, unlike the choice of where to incorporate a subsidiary, the Bank's decision to have or not have an authorized branch or subsidiary in a state other than Delaware was not simply a choice as to the *form* in which business would be conducted. Rather, it was a conscious choice by the Bank as to the location in which the activities giving rise to the income sought to be taxed by Delaware would be conducted; namely, the issuance of CDs and the obtaining of loans from the FHLB at low rates that allowed the Bank to earn significant interest income from the net interest margins between the cost of funds and rates charged on mortgages. For these tax years, Lehman Bank had its headquarters and home office in Delaware. It had no branch or subsidiary elsewhere and had no authority from the federal regulators to conduct its banking functions outside Delaware, and therefore did not and could not earn the income in question in a state other than Delaware.

Thus, Delaware's taxation of the Bank's entire net income under the Bank Tax statute is proper and consistent with this Court's decisions.

C. The Delaware Supreme Court Decision Does Not Conflict With Decisions Of Other States

Neither does the decision of the Delaware Supreme Court conflict with the decisions of other states. Again, there are differences between the present case and the cited cases in regard to the identity and form of taxpayer, the nature of the tax, and other facts and circumstances. But there is no conflict between the constitutional principles identified and applied by the Delaware Supreme Court and the principles identified and applied in each of the cases cited by Petitioner and its amici. Lehman Bank cites *Northwest Energetic Services, LLC v. Franchise Tax Bd.*, 2008 Cal. App. LEXIS 162 (2008), *Northwood Construction Co. v. Township of Upper Moreland*, 856 A.2d 789 (Pa. 2004), *cert. denied*, 544 U.S. 962 (2005), *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia*, 823 A.2d 108 (Pa. 2003), *Southern Pacific Transportation Co., Inc. v. Department of Revenue*, 44 P.3d 1006 (Ariz. Ct. App. 2002), *General Motors Corp. v. City and County of Denver*, 990 P.2d 59 (Colo. 1999), and *General Motors Corp. v. City of Los Angeles*, 486 P.2d 163 (Cal. 1971). None of these cases involved a bank, none of them involved Section 1464(h) of HOLA and none of them involved a taxpayer organized under the laws of the taxing state. In addition, *City of Winchester v. American Woodmark Corp.*, 471 S.E. 2d 495 (Va. 1996), did not involve a bank, and *City of Modesto v. National Med, Inc.*, 27 Cal. Rptr. 3rd 215 (Cal. Ct. App. 2005), did not even interpret the Commerce Clause.

D. The Decision Below Has No Practical Effect Going Forward

A 2006 amendment to the Bank Tax statute gives a bank taxpayer the option to elect a second form of apportionment, based on factors for real and tangible personal property, payroll and receipts, together with a minimum tax. (App. 31a-32a). Del. Code Ann. tit. 5, § 1101A. Since a bank can now opt out of the apportionment system complained of here, the decision by the Delaware Supreme Court has no practical effect going forward. Indeed, the Petitioner conceded that the pre-amendment Bank Tax was the only one of its kind in the country, stating that "Delaware is the only state" to have such an "idiosyncratic statute". (Pet. for Cert. at 21). While Delaware disagrees with the negative characterization of the statute, by Petitioner's own admission, there is no other like it in the country, and in Delaware it is now merely one of two options. Therefore, this Court need not review the decision below.

Amicus U.S. Bancorp argues differently that the same issue raised by Lehman Bank is implicated under the laws of New Jersey, West Virginia and Georgia, but the argument has no merit. All of the statutes cited impose a tax on a wide array of entities, not just banks or an institution otherwise required by federal law to be treated as a domestic financial institution. N.J. Stat. Ann. §§ 54:10A-2, 54:10A-4; W. Va. Code §§ 11-24-3a, 11-24-4; Ga. Code Ann. §§ 48-13-70, 48-13-72. In addition, as to the West Virginia tax, the rule denying apportionment to a financial organization commercially domiciled in West Virginia is repealed for tax years beginning on or after January 1, 2009. S.B. 749, 78th Leg., 1st

Sess., Chapter 247, Acts, Regular Session, 2007 (W. Va. 2007).

Amicus COST argues that the issue raised in this case is somehow "intensified" by the question of whether economic presence is sufficient to confer nexus on a taxpayer. The economic nexus issue is not relevant here. Lehman Bank is physically located in Delaware; no one has ever argued that the Bank does not have nexus with Delaware. Simply put, intensification of an unrelated issue is not a reason for granting review in this case.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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March 27, 2008